VERMILION RESOURCES LTD.

VALUE

FINDERS

ANNUAL REPORT 1998

Vermilion Resources is an international oil and gas exploration and production company based in western Canada. The Company has built its reputation as a "value finder" by investing in long-life reserve assets in Canada and France. Vermilion focuses on operating its core areas, which include light crude oil and liquids-rich natural gas properties in two areas of western Alberta and light crude oil properties in the Paris and Aquitaine basins of France.

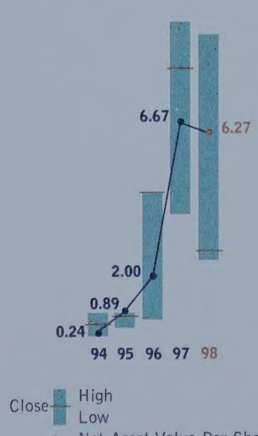
Vermilion's value-added strategy includes a balance of acquisitions, development and exploration, completed over three key stages. With this strategy, Vermilion is maintaining its status as a low-cost finder of oil and gas reserves, operating in countries with complementary fiscal regimes and geological formations.

Vermilion's common shares trade on the Toronto Stock Exchange under the symbol "VRM" and are included in the TSE 300 Composite Index.

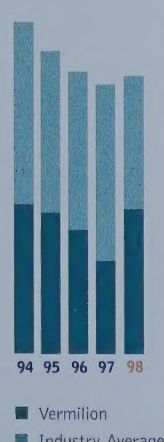
VERMILION HAS INCREASED VALUE ON A PER SHARE BASIS OVER THE COMPANY'S FIVE-YEAR LIFE THROUGH DISCIPLINED IMPLEMENTATION OF ITS VALUE-ADDED GROWTH STRATEGY IN BOTH CANADA AND FRANCE.

SUMMARY

Fiscal Year Ending December 31,	1998	1997
Financial		
$000s except per share amounts		
Petroleum and Natural Gas Revenues	$ 55,660	$ 53,693
Cash Flow from Operations	19,621	26,378
Per Share	0.42	0.70
Net Earnings	3,438	11,358
Per Share	0.07	0.30
Total Assets	264,713	130,231
Total Long-term Debt	93,903	17,549
Shareholders' Equity	$ 123,757	$ 77,722
Common Shares Outstanding,		
Basic, End of Period	49,188,517	42,154,338
Weighted Average	46,705,676	37,773,872
Fully Diluted, End of Period	53,845,160	45,580,231
Operations		
Production		
Crude Oil and NGLs (bbls/d)	7,715	5,476
Natural Gas (mcf/d)	18,676	10,973
Total (boe/d)	9,583	6,573
Average Selling Price		
Crude Oil and NGLs ($/bbl)	14.22	22.04
Natural Gas ($/mcf)	2.29	2.41
Established Reserves		
Crude Oil and NGLs (mbbls)	59,330	40,327
Natural Gas (mmcf)	139,950	104,486
Total (mboe)	73,325	50,775
Undeveloped Land Holdings (net acres)	884,092	256,053
Finding Costs (per proven boe)	$ 6.28	$ 2.34
Net Asset Value Per Share	$ 6.27	$ 6.67



Net Asset Value Per Share vs. Share Trading
$/share



Cumulative Findings Costs Per Proven Boe
$/boe

	Vermilion	Industry
1994	3.95	8.69
1995	3.70	7.87
1996	3.34	7.44
1997	2.54	7.05
1998	3.81	7.30*

*ESTIMATED

BY THINKING LIKE OWNERS, VERMILION'S MANAGEMENT TEAM IS SUCCEEDING AT BRIDGING THE CONTINENTS TO BUILD VALUE IN CANADA AND FRANCE.

CLAUDIO GHERSINICH
EXECUTIVE
VICE PRESIDENT

JEFFREY S. BOYCE
PRESIDENT &
CHIEF EXECUTIVE OFFICER

LORENZO DONADEO
EXECUTIVE
VICE PRESIDENT

Fellow Shareholders:

Throughout our five-year history, Vermilion's management has followed a value-added growth strategy to build our oil and gas business. This strategy has enabled us to grow from an initial $200,000 investment to a current net asset value at year-end 1998 of $337.5 million or $6.27 per share.

This value is reflected in Vermilion's 1998 exit production of 12,500 boe/d; established reserves (proven plus 50 percent probable) totalling 73.3 mmboe; an undeveloped land base of 884,092 net acres; and an extensive infrastructure of operated facilities. A large inventory of exploration and development projects in western Canada and France, managed by our motivated and experienced team of professionals, provides for significant future growth.

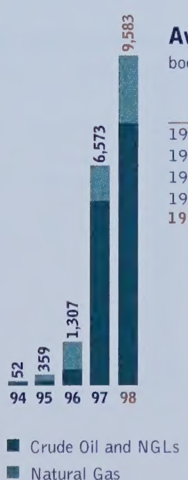
The extent and duration of the crude oil price collapse in 1998 was unprecedented in the history of the oil industry. Understandably, investors have had concerns with respect to the general state of the industry and its impact on our Company, as well as specific questions about strategic decisions that Vermilion's management has made over the year. We would like to take this opportunity to address the most commonly raised issues.

VALUE-ENHANCING ACCOMPLISHMENTS

Vermilion spent $149.8 million in 1998. What did you accomplish of significance?

With that investment, Vermilion added substantial value through a number of key accomplishments. Over the past year we:

- Added 26.1 mmboe of established reserves, representing a replacement ratio of 7.5 times the 1998 production volume;
- Achieved these reserves additions at a cost of $6.28 per proven boe and $5.68 per boe, established;
- Increased average production levels 46 percent from 6,573 boe in 1997 to 9,583 boe in 1998;
- Expanded our undeveloped land position, a dramatic 245 percent from 256,053 net acres a year ago to 884,092 net acres by year-end 1998; and
- Balanced our production between Canada and France by adding Utikuma, a strategic new core area comprised of light crude oil assets located in Northern Alberta.



Average Daily Production
boe/d

	Crude Oil and NGLs	Natural Gas	Total
1994	35	17	52
1995	175	184	359
1996	547	760	1,307
1997	5,476	1,097	6,573
1998	**7,715**	**1,868**	**9,583**

Earnings
$/share

1994	–
1995	0.02
1996	0.09
1997	0.30
1998	**0.07**

STAYING POWER IN A CHALLENGING ENVIRONMENT

Vermilion is 80 percent oil weighted. Can the Company remain profitable at WTI crude oil prices of US$13.00 per barrel?

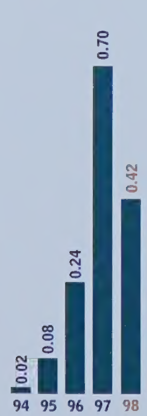
Even at this crude oil price, cash flow remains positive in all of Vermilion's project areas in both Canada and France. A number of key factors enabled us to withstand the weak crude oil markets of late 1998 and early 1999:

- Our crude oil is high-quality, ranging from 32° to 41° API gravity;
- Our production declines remain moderate, ranging from eight to 15 percent;
- Our proven producing reserve base has a long life, with a reserve life index of 11.7 years;
- Our strategy of acquiring and developing operated, high working interest properties has ensured cost control over our projects, as well as the flexibility to manage timing of the expenditures without impairing the value of the project areas; and
- Our high netbacks from natural gas properties provide a strong cash flow base.

Vermilion will be cautious in 1999, ensuring capital expenditures do not exceed cash flow while operating and G&A expenses are tightly controlled. In the first quarter of 1999, we initiated the Profitability Improvement Program (PIP). This company-wide program entailed a complete review of all expenditures by employee teams with a view to reducing costs by five percent. This review has identified $3.0 million in potential cost reductions.

Vermilion has gone from a debt position of $20.4 million at the beginning of 1998 to $110.3 million of debt including working capital deficit by year end. How are you going to manage this debt load?

Vermilion entered 1998 with a relatively clean balance sheet to position ourselves for strategic acquisition opportunities. We raised $40.0 million of equity in the first quarter of 1998 as acquisition opportunities were increasing and management was finalizing the bank facility. Proceeds from the equity financing were used during the quarter to purchase natural gas assets at Chip Lake and to pay off the debt, thereby giving Vermilion



Cash Flow
$/share

1994	0.02
1995	0.08
1996	0.24
1997	0.70
1998	0.42

Vermilion Average Price of Crude Oil
Cdn$/bbl

1994	20.18
1995	19.49
1996	26.93
1997	22.33
1998	14.34

the flexibility to make further acquisitions should the right opportunity present itself. We subsequently made use of financing to add a total of $67.0 million of strategic property acquisitions to the Company's asset base in Canada.

Management uses three criteria to assess and manage the corporate debt level.

First, management attempts to maintain the debt level within two times annualized cash flow, based on a 10-year average WTI price file (currently US$19.20/bbl, excluding Gulf War pricing). Our current higher debt to cash flow multiple is more a symptom of reduced cash flow than excessive debt levels. Based on a ten-year average price file, the Company's debt to cash flow ratio is 1.8 to 1.

Second, the Company limits its debt to equity ratio to no more than 1.5 to 1. At year-end 1998 this ratio was a reasonable 0.89 to 1.

Third, Vermilion ensures cash flow to interest coverage of at least four times. While the Company's debt increased substantially over the year, Vermilion maintained cash flow to interest coverage of eight times in 1998. Therefore, in our opinion, the debt position is manageable and has not put the Company at risk.

SUSTAINED INTERNATIONAL COMMITMENT

I purchased Vermilion stock in 1997 on the basis of the exciting potential in France. Your next material acquisition was in Canada. What is your commitment to international activities?

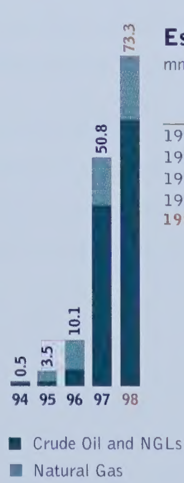
Vermilion remains committed to its French assets and ongoing international activities. Despite lower crude oil prices and severely reduced operating netbacks in France during 1998, Vermilion remained active. The Company drilled eleven 100-percent wells, shot and reprocessed extensive seismic data, expanded its production, reserves and facilities infrastructure, while growing the undeveloped land base to 765,175 net acres. The Company also has a significant development and exploratory prospect inventory that will be drilled as crude oil prices improve.

In addition to these activities, in 1998 Vermilion made two unsuccessful attempts at acquiring other complementary producing assets in France and Europe.

Undeveloped Land Holdings

000s net acres

	Canada	France	Total
1994	1.3	–	1.3
1995	18.9	–	18.9
1996	45.5	–	45.5
1997	59.5	196.6	256.1
1998	**118.9**	**765.2**	**884.1**



Established Reserves

mmboe

	Crude Oil and NGLs	Natural Gas	Total
1994	0.4	0.1	0.5
1995	2.0	1.5	3.5
1996	4.1	6.0	10.1
1997	40.3	10.5	50.8
1998	**59.3**	**14.0**	**73.3**

Our most recent acquisition of assets in Canada served to balance our production between Canada and France but should not be taken as an indication that we are retreating from the international arena. Vermilion is foremost a value-driven company, and as Canadian asset valuations became more attractive, the Company entered that market.

Vermilion believes that significant oil and gas opportunities remain in France and G-7 Europe. We will continue to pursue opportunities that add value to our company and its shareholders.

UNDERSTANDING VERMILION'S INHERENT VALUE

Why should I buy or hold Vermilion stock?

The severe drop in the oil and gas index in 1998 has left investors searching for value in the marketplace. Vermilion's management believes that the Company's shares represent good value in the marketplace for the following reasons:

- Quality, operated, long life, low decline asset base;
- Well-managed company demonstrated by historical finding costs of $3.81 per proven boe;
- Shares currently trading at a substantial discount to the year-end net asset value of $6.27 per share;
- Management, directors and employees control 23 percent of the Company's fully diluted shares, ensuring strong alignment with shareholders;
- Significant oil price leverage providing shareholders with substantial upside potential; and
- Extensive inventory of drilling prospects in two countries ensuring future growth.

OUTLOOK FOR 1999

In an environment of constantly changing crude oil pricing, Vermilion has restricted 1999 spending to cash flow from operations. Under our US$15.00 WTI base case price forecast, the Company's operations would generate approximately $40 million in cash flow. In the event of sustained improved crude oil pricing, we would prudently increase our spending to reflect the resulting higher cash flow. Our 1999 capital program will focus initially on development and exploratory natural gas drilling at Chip Lake, Alberta, along with low-cost, high-impact reactivation, recompletion and infill drilling work at Utikuma and in France.

Vermilion exited 1998 producing 12,500 boe/d and expects to average 12,300 boe/d in the first quarter of 1999. During 1999, the Company will continue to make the necessary improvements needed to grow in this uncertain commodity price environment. In that regard, Vermilion has embarked on a company-wide cost-cutting program, targeting a five-percent reduction in overall capital, operating and general and administrative costs.

It is important for our shareholders to understand that crude oil and NGLs make up approximately 80 percent of Vermilion's production and, as a result, the corporate cash flow is very sensitive to a change in crude oil pricing. A US$1.00 per barrel change in the WTI price would create a Cdn$5.4 million change in our cash flow, or $0.11 per share. This provides Vermilion and its shareholders with significant upside potential as the commodity price continues to improve. In the shorter term, our consistent value-added growth strategy, quality asset base and large inventory of oil and gas development and exploration projects, enhanced by an aggressive cost-cutting program, will ensure we work through this changing commodity price environment and position the Company for value-added growth in the years to come.

We are pleased to welcome Mr. Joseph F. Killi to Vermilion's Board of Directors. Mr. Killi brings many years of corporate finance experience to our Board and we look forward to his valuable contribution.

On behalf of the executive, I would like to thank the directors and employees for their valuable contributions and effort during this severe industry downturn. In addition, we would like to express our appreciation to all of our shareholders for their continued faith in management and their ongoing financial support.

Jeffrey S. Boyce
President & Chief Executive Officer
April 28, 1999

VERMILION'S PROPERTIES IN CANADA AND FRANCE SHARE CERTAIN KEY CHARACTERISTICS:
OPERATED, HIGH-QUALITY, LONG-LIFE RESERVES;
HIGH WORKING INTERESTS; FACILITIES CONTROL; AND GROWTH POTENTIAL.

VALUE-DRIVEN GROWTH STRATEGY

Acquisition of a core asset followed by:

Phase 1: Exploitation and Netback Enhancement

Exploitation, cost reduction and optimization targeted to double the asset value.

Phase 2: Consolidation and Acquisition

Acquisition of other strategic assets in the area.

Phase 3: Exploration

Exploration plan to extend current fields and explore for new horizons and pools.

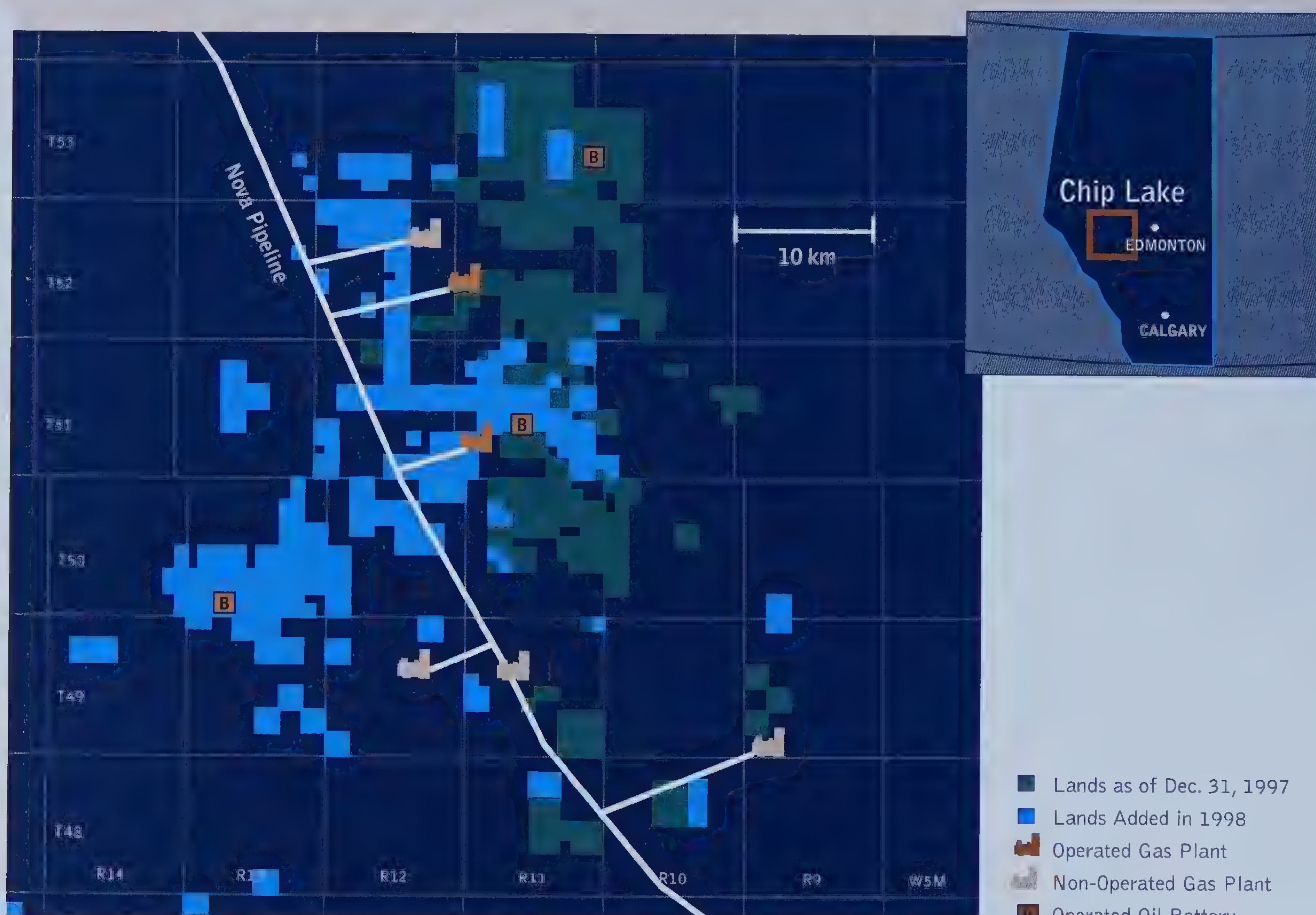
CANADIAN OPERATIONS

Average 1998 Production	3,394 boe/d
Production Split	50% oil and NGLs
	50% gas
Established Reserves	
Oil	10.6 mmbbls
NGLs	7.8 mmbbls
Gas	129.9 bcf
Undeveloped Land	
Gross	179,059 acres
Net	118,917 acres

FRENCH OPERATIONS

Average 1998 Production	6,189 boe/d
Production Split	97% oil and NGLs
	3% gas
Established Reserves	
Oil	40.9 mmbbls
Gas	10.1 bcf
Undeveloped Land	
Gross	1,457,500 acres
Net	765,175 acres

Chip Lake is now in the third stage of Vermilion's three-phase development strategy. As one of the Company's first properties, Chip Lake provides a useful template for illustrating Vermilion's strategic approach to building the Company's asset base. The original property, acquired in April 1996 for $11.3 million, included 13 gas wells, three oil wells, 26 sections of undeveloped land and a 35 percent non-operated interest in the Amoco Granada Gas Plant. At the time of the acquisition, production averaged 800 boe/d with an established reserve base of 3.6 mmboe. The following discussion details Vermilion's three-phase strategy highlighting the impact of these activities at each stage.



Phase 1: Exploitation and Netback Enhancement

During the first nine months of operatorship, Vermilion undertook a number of activities designed to cut costs, enhance revenue and increase production and reserves. Field condensate was injected into the gas gathering system to eliminate trucking costs. Gas marketing contracts were renegotiated to improve the contract price. Production was increased by stimulating four wells and installing vertical lift systems in liquids-rich gas wells. Four oil wells, defining a new pool, and two gas wells were drilled, adding substantially to the reserve base. An additional 25 sections of land were acquired along with a shut-in gas well which was immediately tied in. By the end of 1996, production had increased to 1,400 boe/d and reserves had reached 7.0 mmboe with an established value of $49.6 million.

CHIP LAKE EXEMPLIFIES VERMILION'S STRATEGIC APPROACH TO BUILDING THE COMPANY'S ASSET BASE.

In 1997, Vermilion constructed a 1,000 bbl/d oil battery and implemented a gas conservation scheme for its new oil field. Fourteen gas wells were drilled, many on a 25,000 acre farm-in block which complemented the Company's land position in the area. By year-end 1997, exit production was 1,700 boe/d and reserves had increased to 12.4 mmboe with an established value of $65.9 million. At this point, Vermilion had invested approximately $38.0 million in the property.

SUMMARY

Producing Formations	Cardium
	Rock Creek
	Ostracod
	Nisku
Average Working Interest	72%
1998 Average Production	3,030 boe/d
Established Reserves	
Oil	2.9 mmbbls
NGLs	5.5 mmbbls
Gas	73.0 bcf
Undeveloped Land	
Gross	114,560 acres
Net	80,558 acres
Property Value @ PVBT 15% (Established Reserves)	$92.5 million

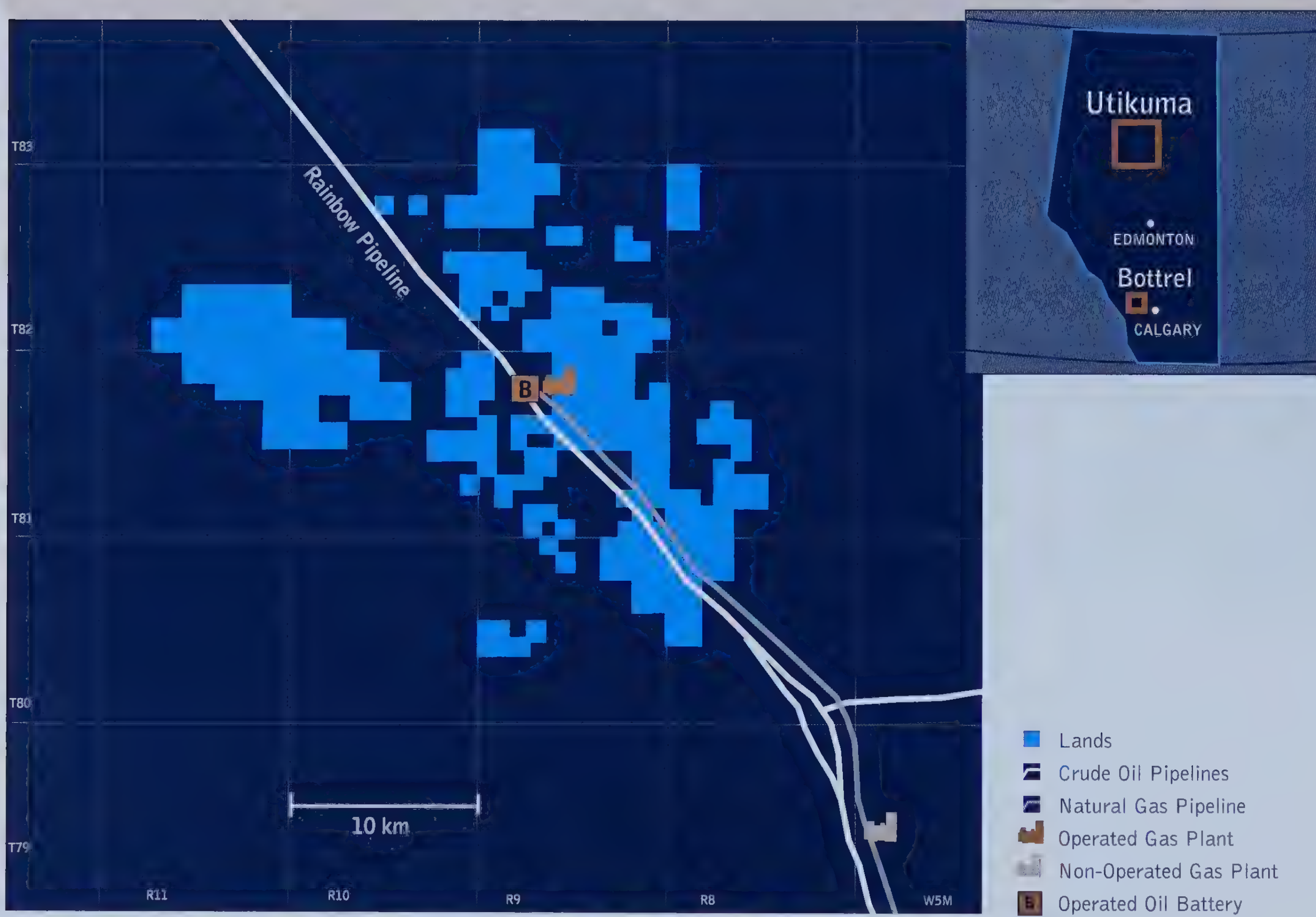
Phase 2: Consolidation and Acquisition

Encouraged by its success, the Company embarked on a consolidation strategy, with the primary objectives of securing more proprietary plant capacity for its newly found gas and expanding its drillable land portfolio. On March 1, 1998, the Company was successful in increasing its ownership at the Granada Plant to 62 percent and assumed operatorship. Four acquisitions were completed ranging in size from one shut-in gas well with some undeveloped land to a major deal which brought the Company a second operated gas plant; operatorship of a 2,500 bbl/d oil battery; 750 boe/d of production potential; and 103 gross sections of undeveloped land. At the same time, the Company drilled 22 wells, 20 of which were successful, identifying several new gas accumulations ranging in size up to 25 bcf. By the end of 1998, Vermilion had established itself as the principal operator in the Chip Lake project area. The Company had operatorship of two gas plants and ownership in a third, resulting in a combined processing capacity of over 75 mmscf/d; an operating network of over 200 kilometres of gas gathering systems; three oil batteries with treating capacity of over 5,000 bbls/d, one of which provides access to the local oil transmission line; ownership in some 150 wells, most of which are operated by the Company; and varying interests in 272 gross sections of land. At year-end, Vermilion was producing almost 4,300 boe/d and reserves had increased to 15.6 mmboe with an established value of $92.5 million.

Phase 3: Exploration

While the Company continues to assess the merits of further consolidation, the next significant reserve additions will likely come from its exploration efforts. The 1998 acquisitions included undeveloped land that extended Vermilion's exposure to other deeper prolific gas prospects. Vermilion has already identified two locations on its lands targeting a zone capable of five to 10 million standard cubic feet per day from a reserve base of 10 to 15 bcf. Success with these wells could immediately increase the Company's total gas production by 50 percent, and would lead to a series of development wells to further augment the production impact. The Chip Lake drilling budget for 1999 has been set at $16.2 million.

The Utikuma field was discovered in 1963 with the drilling of the 10-27-81-9 W5M well, which is still on production today. The majority of the field's long-life reserves are assigned to the Keg River sandstone. The Company operates a central battery facility at 16-29-81-9W5M where it handles all of the fluids produced from the Utikuma field, as well as third-party volumes.



THE ADDITION OF UTIKUMA, A STRATEGIC NEW CORE AREA, BALANCED VERMILION'S PRODUCTION BETWEEN CANADA AND FRANCE.

Utikuma is the Company's latest acquisition and has provided a new core area. This property has all the characteristics the Company looks for in a new core area: operated infrastructure; material working interest; ownership by a major company that has not been actively exploiting the properties in recent years; fields with a long production history and predictable declines; reactivation and recompletion potential in existing producing or bypassed formations; lifting cost reduction and third-party revenue generating opportunities; infill drilling and field delineation potential; undeveloped land; and additional possibilities for consolidation. The addition of this area has increased the Company's 1998 year-end production by 16 percent and the established reserve base by over 12 percent, and has balanced production between Canada and France.

SUMMARY

Producing Formations	Keg River sandstone
	Gilwood
	Slave Point
Average Working Interest	55%
1998 Average Production (Annualized)	1,750 boe/d
Established Reserves	
Oil	7.7 mmbbls
Gas	2.2 bcf
Undeveloped Land	
Gross	40,000 acres
Net	28,728 acres
Property Value @ PVBT 15%	
(Established Reserves)	$40.9 million

Phase 1: Exploitation and Netback Enhancement

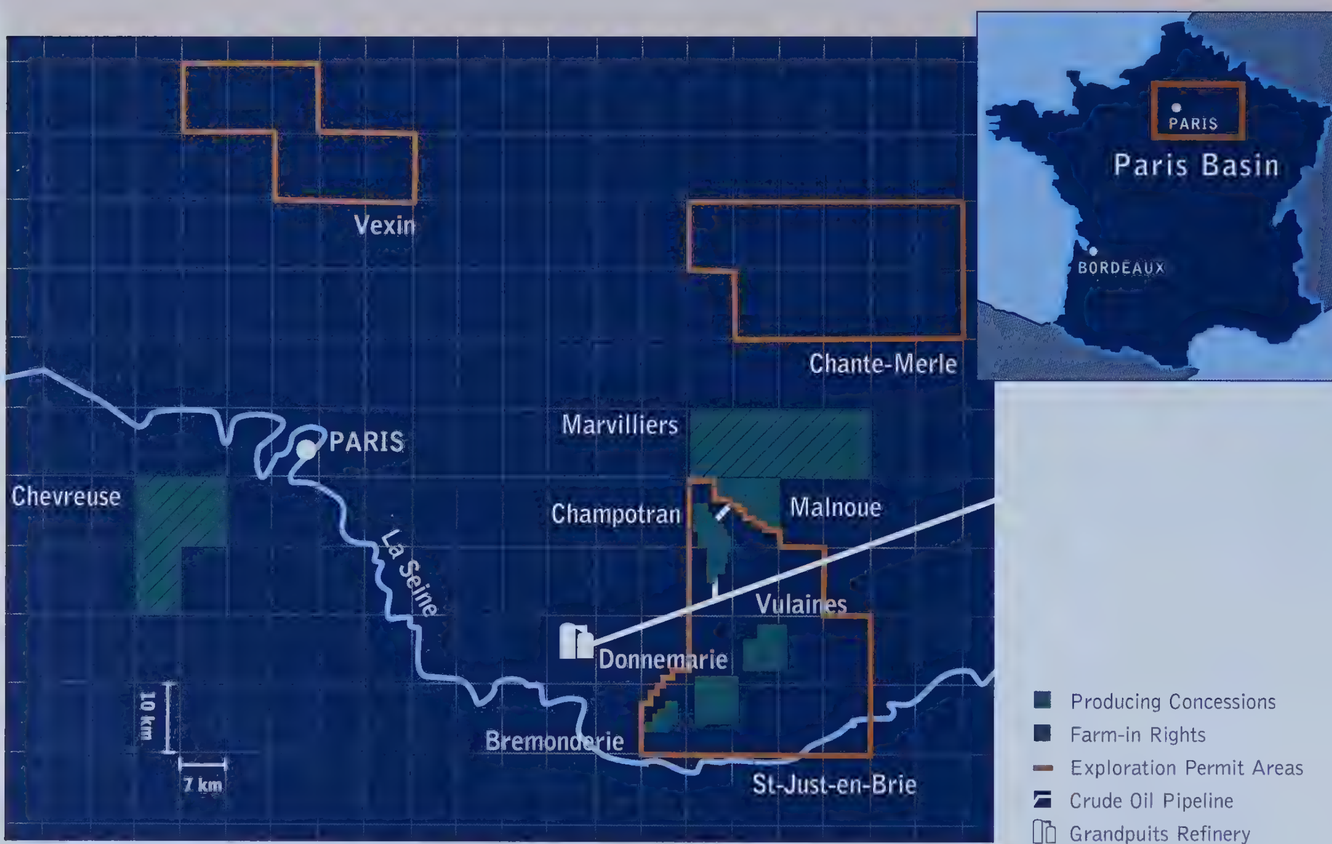
Vermilion assumed operatorship of Utikuma on December 1, 1998 and immediately implemented a program to improve the profitability of the property. The field now operates with fewer staff; the new employees have assumed the maintenance work program rather than allocate it to third-party contractors; and charges for oil treating, oil storage, water handling, water disposal, road usage and gathering system have been optimized. A team has been assembled to exploit the potential of the property. The results to date have been encouraging, with up to 15 drillable locations confirmed and eight workovers scheduled for 1999. Vermilion's geologists are currently mapping six different exploration play types for both gas and oil in the area. Already, one discovery with considerable development potential has been made adjacent to the property.

MINOR PROPERTIES: BOTTREL

Phase 3: Exploration

The Bottrel project area, located just west of Calgary, has gained some prominence of late in the Company's activity. Vermilion owns a 33 percent working interest in this non-operated property, which includes 20,102 gross acres of undeveloped land. The main producing zone in the area is the Cardium which produces from thrusted anticlines, but in the fall of 1998 the Company made a discovery in a deeper, more prolific thrusted zone. Initial indications are extremely encouraging. Two to three additional locations are planned for early 1999, with the aim of initiating production in the middle of 1999.

While oil was found in the Paris Basin as far back as the late 1950s, it wasn't until the early 1980s that significant capital was spent exploring for new fields. Renewed interest in these fields was triggered in part by changes to France's royalty structure. However, most of the discoveries (under 10 mmbbls recoverable) were too small for companies like E.A.E.P.F. (Elf), Total and Esso R.E.P. Total was the first company to withdraw from the region and in 1997 Esso followed suit, selling its smaller assets to Vermilion. Elf has since divested several small properties to Madison/Chart Energy S.C.S. It is in this type of changing environment that Vermilion's management has been successful in the past.



Phase 1: Exploitation and Netback Enhancement

The Paris Basin project area has undergone a material transformation since Vermilion assumed operatorship in May 1997. During the first eight months, the Company reactivated several suspended wells and recompleted one well at Vulaines and a second at Malnoue. Initial results indicated significant potential in the Dogger formation. Vermilion initiated its drilling program in the fall of 1997 with the last well of the program drilled in November 1998. To date, the Company has drilled eight wells: three at each of Vulaines and Champotran, one at Malnoue and an exploration well that tested an anomaly on the Vexin permit. Of the eight wells drilled, only the exploration well was found to be dry and was abandoned.

IN THE PARIS BASIN, VERMILION WILL FOCUS ON REDUCING COSTS AND ADDING PRODUCTION THROUGH THE DRILL BIT.

The five successful exploitation wells have been the primary contributors to the more than 100 percent production increase in the Paris Basin, from 988 barrels of oil per day in 1997 to the current 2,000 barrels of oil per day, although Vermilion has yet to stimulate any of these wells. In 1999, most will be stimulated to assess the impact on productivity. The latest well at Vulaines, drilled to test a deeper formation which was found to be tight, is now awaiting completion in the producing Dogger formation. One of the Champotran wells tested oil during the drilling operation but produced mostly water after completion (in a field with less than five percent water cut) and therefore requires a remedial cement squeeze or possibly a redrill. The Company has an inventory of drillable exploitation locations in its fields, but will not pursue these until there is a material and sustained commodity price increase.

SUMMARY

Producing Formations	Jurassic-aged carbonates
	Dogger (Callovian & Bathonian)
	Triassic-aged sandstones
	Chaunoy
Average Working Interest	100%
1998 Average Production	1,794 boe/d
Established Reserves	
Oil	10.9 mmbbls
Undeveloped Land	
Gross	587,000 acres
Net	439,625 acres
Property Value @ PVBT 15% (Established Reserves)	$71.5 million

In response to the dramatic decline in commodity prices throughout 1998, Vermilion has made lifting cost control a top priority. The capital spent in 1998 to reactivate an oil transmission line connected to the local refinery will pay dividends for the Champotran and Malnoue fields. A number of low-cost capital projects scheduled for 1999 will continue to reduce trucking and water handling costs for the area.

Phase 2: Consolidation and Acquisition

Vermilion is intent on growing its resource base in this project area and has contacted the other producers to gauge their interest in divestiture. The new entrants appear to be willing to try to stay the course while the majors may consider another round of rationalizations in the next 12 to 18 months. In the meantime, the Company will focus on reducing costs and adding production through the drill bit as appropriate.

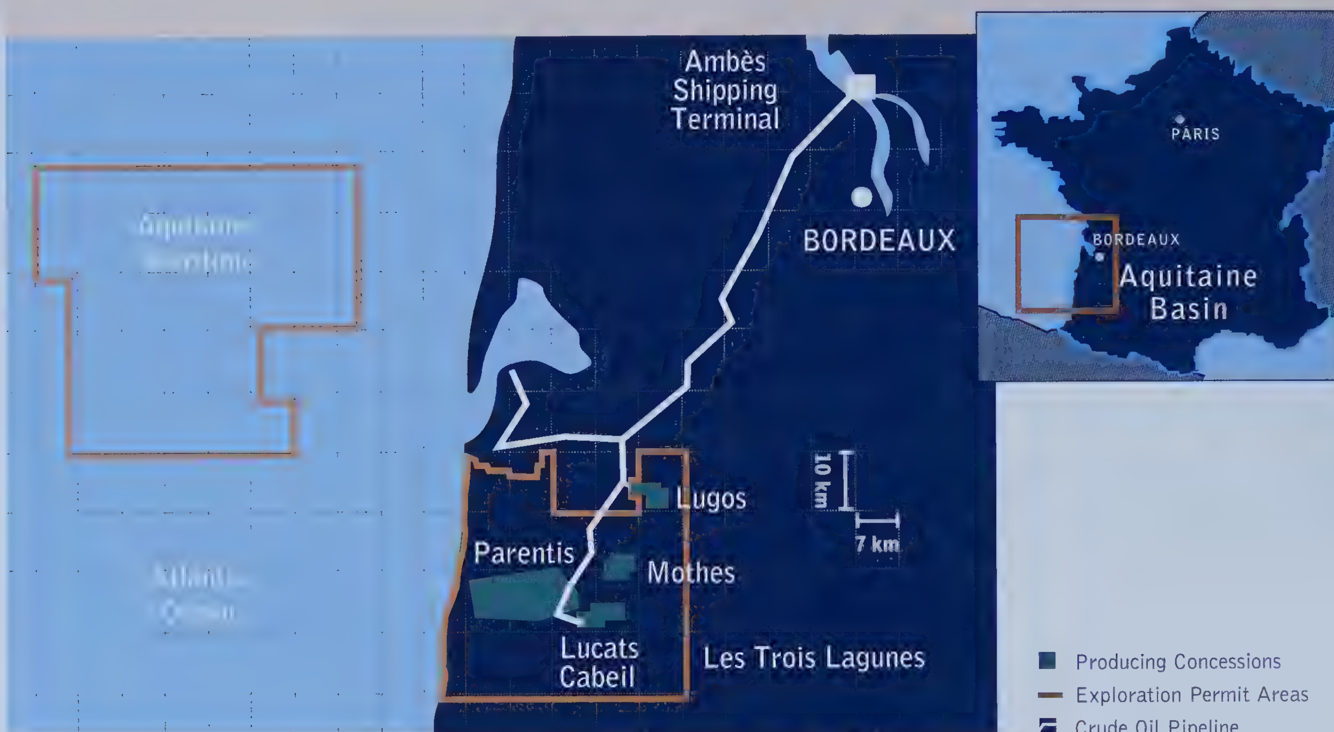
Phase 3: Exploration

The Company is well advanced in the exploration phase of its development in the Paris Basin. In the fall of 1998, Vermilion drilled its first exploration well in France on a farm-in on the Vexin permit. This high-risk well was dry and abandoned in the main Triassic target zone but supplied encouraging evidence for a shallower Dogger (Jurassic) play. Consequently, the permit was renewed for a further four years at 100 percent working interest.

The Company has come to an agreement on a 193,750 acre exploration permit (St-Just-en-Brie) surrounding its main producing concessions, and is investigating new plays as well as pool extensions on this sparsely drilled acreage.

Vermilion expects to be awarded 50 percent of another exploration permit (Chante-Merle) in the north part of the Paris Basin in early 1999, and is currently working on farm-in deals to earn a working interest in two other permits. When all this work is completed, the Company will own 439,625 net exploration acres in the Paris Basin alone.

The Aquitaine Basin will likely enter the second stage of the Company's strategy during the next 12 to 18 months. Vermilion has established the viability of this area and is now comfortable that significant potential exists not only in the exploitation of its fields but also in several exploration plays identified. A limited number of acquisition targets will be pursued aggressively; however, any success will be dependent on the vendors' willingness to sell assets. In the meantime, Vermilion will continue to expand on opportunities identified in the first phase of the strategy.



Phase 1: Exploitation and Netback Enhancement

Vermilion initiated the first phase of its strategy in the Aquitaine Basin in the summer of 1997 with the reactivation and recompletion of 29 wells. Three 3D seismic programs were shot over the Company's three smaller fields: Lugos, Mothes and Lucats-Cabeil. In addition, a rigorous interpretation of a 25-square-kilometre 3D seismic program over the structurally-complex field of Parentis was completed. From these interpretations, along with extensive geological and reservoir studies, an initial drilling program was defined, with the aim of investigating field potential rather than accelerating production from the extensive reserve base.

Parentis is a world-class oil field, having already produced close to 215 mmbbls of oil from dolomitized carbonates of Barremian age. However, two upper zones of the Barremian (the R1 and R2) remain largely unexploited. Reservoir studies estimate in excess of 100 mmbbls of oil in place in these two zones, only a small percentage of which has been produced to date. The ultimate recovery factor is the key and in 1998, two wells were drilled to investigate how efficiently

PRODUCTION OF CLEAN OIL FROM NEW WELLS IN AN AGING RESERVOIR BODES WELL FOR THE AQUITAINE BASIN

the zones could be exploited using horizontal well technology. One well was successful and is producing at a flat rate of 200 bbls/d. This well recovered 56,000 bbls in its first eight months of production. The second well encountered better reservoir rock but appears to have been damaged from drilling. This well is awaiting acid stimulation. The Company has identified up to 50 similar horizontal locations. A third well was also successful in demonstrating the presence of undrained oil in the lower zones on isolated fault blocks.

SUMMARY

Producing Formations	Cretaceous carbonates and sandstones
Average Working Interest	100%
1998 Average Production	3,896 boe/d
Established Reserves	
Oil	20.9 mmbbls
Gas	10.1 bcf
Undeveloped Land	
Gross	870,500 acres
Net	325,550 acres
Property Value @ PVBT 15% (Established Reserves)	$139.6 million

Vermilion then drilled two wells at Mothes. One well was designed to test attic oil potential and was extended laterally to investigate the potential of undrained oil on the flank. Although several productive intervals were identified, the well encountered several significant fractures and as a result, produces primarily water. A remedial program is being designed. The second well at Mothes successfully proved up a discreet structure identified on Vermilion's recently acquired 3D seismic.

Efforts from this first phase of activity have resulted in a production increase of 143 percent, from 2,800 bopd to over 4,000 bopd, while established reserves have more than doubled, increasing from 13.3 mmboe to 31.0 mmboe.

In the fall of 1998 Vermilion applied for a 265,000-acre exploration permit (Les Trois Lagunes) surrounding its producing concessions. The success of the second Mothes well has given the Company considerable encouragement that a myriad of smaller hydrocarbon bearing structures may be present, trapping the main producing reservoir (Barremian) in this part of the basin. The Company will also investigate other exploration play types such as the Albo-Aptian reef complex and the Purbeckian sands in the north of the permit. It is anticipated that the permit will be awarded in mid-1999.

PRODUCTION

Vermilion's 1998 production averaged 9,583 boe/d, reflecting a 46 percent increase over the prior year. Incremental production in Canada was 1,697 boe/d, while France contributed the remaining 1,313 boe/d. Natural gas development drilling activity at Chip Lake and crude oil development drilling in both the Paris and Aquitaine Basins in France increased production by 2,950 boe/d. The Company added 2,850 boe/d of production through acquisitions in 1998, of which 1,750 boe/d relate to the December 1998 Utikuma acquisition, and therefore had minimal impact on the 1998 average.

Property Production Summary

	1998 Oil and NGLs (bbls/d)	1998 Gas (mmcf/d)	1998 Average (boe/d)	1997 Oil and NGLs (bbls/d)	1997 Gas (mmcf/d)	1997 Average (boe/d)	1996 Average (boe/d)
Canada							
Chip Lake	1,444	15.86	3,030	654	7.02	1,356	794
Utikuma	155	–	155	–	–	–	–
Other	89	1.20	209	149	1.92	341	513
Total Canada	1,688	17.06	3,394	803	8.94	1,697	1,307
France							
Aquitaine Basin	3,896	–	3,896	3,120	–	3,120	–
Paris Basin	1,794	–	1,794	988	–	988	–
Other	337	1.62	499	565	2.03	768	–
Total France	6,027	1.62	6,189	4,673	2.03	4,876	–
Combined Total	7,715	18.68	9,583	5,476	10.97	6,573	1,307

LIFTING COSTS

In 1998, Vermilion's lifting costs dropped by six percent to $5.51 per boe. Crude oil and NGLs lifting costs of $15.1 million or $5.37 per barrel in 1998 compare to $11.5 million or $5.73 per barrel in 1997. In France, lifting costs for crude oil were reduced on a volumetric basis from $6.01 per barrel in the prior year to $5.60 per barrel in 1998. The Company remains focused on reducing lifting costs in all areas through its intensive profitability improvement program. The target for operating costs in France remains at $5.00 per barrel in 1999, as operating efficiencies initiated over the past year have been partially offset by pipeline and well repair programs that began in 1998 and continue into 1999. The Utikuma property acquired late in 1998 is expected to provide a favourable impact on lifting costs as Vermilion has begun streamlining the operations and enhancing plant recoveries.

Lifting Costs
$/boe

	Canada	France	Average
1994	4.64	–	4.64
1995	4.07	–	4.07
1996	3.16	–	3.16
1997	4.29	6.42	5.87
1998	4.39	6.13	5.51

Natural gas lifting costs of $4.2 million or $0.61 per mcf in 1998 can be compared to $2.6 million or $0.66 per mcf in the prior year. During the year, the Company enhanced and rebuilt compressor facilities during its plant turnaround process to ensure optimization of plant excess capacity for future drilling operations. This had a negative impact on lifting costs in 1998 not expected to recur in

1999. Significant reductions occurred over the year, as fourth quarter lifting costs were reduced to $0.35 per mcf. High lifting costs in France, resulting from third-party processing costs and other repairs, will have a less material impact on the Company's operations as growth continues in Vermilion's Canadian gas production. The target for natural gas lifting costs for the Company is $0.40 per mcf.

RESERVES

During 1998, Vermilion added 23.6 mmboe of proven reserves and 5.0 mmboe of probable reserves. Based on capital expenditures of $149.8 million, the Company's finding and development costs were $6.28 per boe proven and $5.68 per boe established. Vermilion produced 3,498 mboe for the year, resulting in a proven replacement ratio of 6.7 and an established replacement ratio of 7.5. With the additions, the Company's year-end reserve base has increased to 62.9 mmboe proven and 73.3 mmboe established. Of the proven reserves, 87 percent are in the proven producing category. Based on the December 1998 production volume, Vermilion's reserve life index (RLI) is 11.7 years. The Company's internal goal is to reach an RLI balance of 10 years based on its producing reserve base. The current variance in the project areas ranges from nine years at Utikuma to 13 years in the Aquitaine Basin.

Corporate reserves strength can be demonstrated through the Company's proven reserves per share ratio which has risen from 0.2 in 1995 to the current 1.3 which is based on 49.2 million shares outstanding.

Summary of Reserves

January 1, 1999	Oil and NGLs (mbbls)	Gas (mmcf)	Combined (mboe)	NPV @ 10% BT ($000s)	NPV@ 15% BT ($000s)
Canadian Assets					
Total Proven	15,293	114,440	26,737	212,629	164,298
Probable	6,339	30,825	9,422	47,373	29,576
Total Proven Plus 50% Probable	18,463	129,853	31,448	236,331	179,092
French Assets					
Total Proven	35,330	8,700	36,200	268,902	194,200
Probable	11,074	2,794	11,353	61,107	33,649
Total Proven Plus 50% Probable	40,867	10,097	41,877	299,455	211,025
Combined Assets					
Total Proven	50,623	123,140	62,937	481,531	358,498
Probable	17,413	33,619	20,775	108,480	63,225
Total Proven Plus 50% Probable	59,330	139,950	73,325	535,786	390,117

Reserve Reconciliation (Proven)

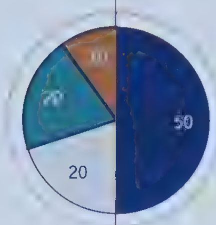
Fiscal Year Ending December 31, 1998	Oil and NGLs (mbbls)	Natural Gas (mmcf)	Total (mboe)
Canada			
December 31, 1997	5,488	70,399	12,527
Production	(616)	(6,224)	(1,238)
Additions	2,465	27,745	5,240
Acquisitions/Dispositions	8,697	31,599	11,857
Revisions	(741)	(9,079)	(1,649)
December 31, 1998	**15,293**	**114,440**	**26,737**
France			
December 31, 1997	29,058	12,890	30,347
Production	(2,200)	(593)	(2,259)
Additions	8,634	-	8,634
Acquisitions/Dispositions	-	-	-
Revisions	(162)	(3,597)	(522)
December 31, 1998	**35,330**	**8,700**	**36,200**
Combined			
December 31, 1997	34,546	83,289	42,874
December 31, 1998	**50,623**	**123,140**	**62,937**
Changes	16,077	39,851	20,063
Percentage Change (%)	47	48	47

The reserve reconciliation table represents the year-over-year change in the Company's proven reserve position. Note that the downward revisions in both Canada and France were on the Company's non-core, non-operated properties. Specifically, 85 percent of the Canadian revision was attributed to reclassification of reserves at Bottrel and 65 percent of the French revision was attributed to a reduction of reserves at Vic Bihl.

MARKETING

Natural Gas

Natural Gas Sales in Canada
%



The Company's natural gas marketing strategy is based on developing a diversified portfolio of contracts to manage its exposure to natural gas price risk. Vermilion's current portfolio allots 50 percent of natural gas sales to major aggregator markets. An additional 20 percent is allocated to a premium-priced, three-year fixed pricing contract, while 10 percent of sales go to a one-year fixed pricing contract. The remaining 20 percent will be utilized to capture attractive spot pricing during peak winter months.

The average price received for Vermilion's Canadian natural gas production strengthened to $2.23 per mcf in 1998 compared to $1.99 per mcf in 1997. This price increment is primarily a result of increased take-away pipeline capacity for Canadian gas. With the significant expansions of the Northern Border and TransCanada pipeline systems in 1998 and an ongoing tightening of the North American supply/demand balance, gas prices are expected to remain strong over the long term.

Crude Oil and NGLs

In France, Vermilion markets a high-grade 32° API gravity blend of crude oil directly to the refineries. The Company receives a Brent-based price, adjusted for quality and transportation. In the Paris Basin, production is sold directly to the Elf Grandpuits refinery. This crude oil is transported through a newly constructed pipeline lateral that delivers the oil directly to the refinery. Aquitaine Basin production is shipped by pipeline to a storage facility at Ambès, and from there by tanker to Elf's Donges refinery.

In France, the average price received for crude decreased 38 percent in 1998 to $13.69 per barrel compared to $22.18 per barrel in 1997, as a direct result of the drop in world oil prices. With consumption of crude oil contracting in Asia, global demand has been reduced creating a supply glut that is putting significant pressure on pricing. Vermilion is confident the stabilization of Asian economies, coupled with a greater than expected decline of world-wide oil supply and mounting pressure on OPEC, will result in a strengthening of oil prices to more normal trading ranges in 1999.

In Canada, Vermilion's crude oil has an average API gravity of 41°. This oil, which is primarily sold through short-term contracts, attracted an average price of $18.99 per barrel in 1998. The high quality of the Company's crude oil production yielded 94 percent of the Edmonton posted price for light gravity crude. The average crude oil and NGLs price for 1998 decreased 24 percent to $16.11 per barrel, compared to $21.20 per barrel in 1997.

IN 1998, MANAGEMENT MADE A COMMITMENT
TO ITS EXPLORATION ACTIVITIES
BY SIGNIFICANTLY EXPANDING THE GEOSCIENCE TEAM.

EXPLORATION

In order to implement Phase 3 of its corporate strategy, Vermilion expanded its geoscience staff in 1998, to seven geologists, two geophysicists and two geotechnicians. Of the geologists, four are working exclusively on exploration projects, either in Canada or France. This represents a significant commitment by the Company's management to augment acquisition and exploitation activities with the discovery of new pools in order to allow for continued growth in each core area.

The Vermilion exploration strategy will be focused on high-quality reserves (minimum of seven years reserve life index): multi-zone potential; multi-commodity exposure; high-quality reservoirs; and seismically definable play types, in or adjacent to its core areas. As was the case with the Utikuma purchase, the exploration upside of an area will be assessed at the same time as the exploitation potential, to ensure continued growth of the project area through all three phases of the strategy.

In an effort to balance its commodity exposure in 1999, the Company will focus on finding and developing natural gas reserves.

Drilling Activity

# of wells	1998		1997		1996	
	Gross	Net	Gross	Net	Gross	Net
Canada						
Oil	5	5.0	3	2.7	6	5.7
Gas	16	12.5	11	10.5	3	1.4
Dry	3	2.2	1	0.4	1	0.7
	24	19.7	15	13.6	10	7.8
France						
Oil	8	8.0	2	2.0	–	–
Gas	-	-	–	–	–	–
Suspended	2	2.0	–	–	–	–
Dry	1	1.0	–	–	–	–
	11	11.0	2	2.0	–	–
Total	35	30.7	17	15.6	10	7.8

Undeveloped Land Holdings

Year ended December 31, 1998	Gross Acres	Net Acres	Value
Canada			
Chip Lake	114,560	80,558	6,508,232
Utikuma	40,000	28,728	3,020,118
Other	24,499	9,631	708,619
	179,059	118,917	10,236,969
France			
Aquitaine Basin	265,000	265,000	7,618,750
Paris Basin	587,000	439,625	12,640,437
Aquitaine Maritime	605,500	60,550	1,740,813
	1,457,500	765,175	22,000,000
Total	1,636,559	884,092	$ 32,236,969

Total undeveloped land holdings in France include 265,000 gross and net acres relating to the Les Trois Lagunes exploration permit that are currently pending government approval. Farm-in rights under option covering 116,000 gross acres and 58,000 net acres are also included.

Land valuation in France is based on Vermilion's capital commitments to retain the permits. Value is allocated equally to each acre of undeveloped land at approximately $28.75 per acre.

VERMILION DEMONSTRATED GROWTH AND PROFITABILITY DURING THE LOW COMMODITY PRICE CYCLE OF 1998.

This discussion should be read in conjunction with the Consolidated Financial Statements on pages to 34 to 37.

All amounts included in the financial statements and this discussion are consolidated and are in Canadian dollars, unless otherwise stated, with the French subsidiary's currency translated as per Note 1 of the financial statements.

The collapse of crude oil prices in 1998 has had broad repercussions throughout the oil industry, severely undermining the financial security of many oil companies. Vermilion, with approximately 80 percent of its current production in the form of crude oil and NGLs, has been exposed to the volatility of the crude oil markets over the past year. A low-cost asset base, coupled with a strong balance sheet heading into this environment, enabled Vermilion to manage the impact of the depressed marketplace, increase its production base and exit the year recording a profit.

Cash Flow and Net Earnings

	1998	1997	1996
Revenue ($000s)	**55,660**	53,693	9,323
Net Earnings ($000s)	**3,438**	11,358	1,866
Per Share	**$ 0.07**	$ 0.30	$ 0.09
Cash Flow ($000s)	**19,621**	26,378	5,169
Per Share	**$ 0.42**	$ 0.70	$ 0.24
Earnings to Cash Flow Ratio (%)	**17.5**	43.0	36.1

Cash flow from operations and earnings declined by 26 percent and 70 percent, respectively, reflecting the dramatic downturn in crude oil pricing over the year. The 46 percent increase in 1998 production levels was nonetheless instrumental in offsetting this cash flow erosion. A combination of low oil prices and higher finding costs significantly impacted the Company's recycle ratio that dropped to 0.9. Looking forward, Vermilion has targeted finding costs of $5.00 per boe and a recycle ratio in excess of two.

Cash Flow Reinvestment

	1998	1997	1996	1995
Finding Costs (per proven boe)	**$ 6.28**	$ 2.34	$ 3.16	$ 3.64
Cash Flow Netback (per boe)	**$ 5.56**	$ 11.00	$ 10.78	$ 8.28
Recycle Ratio	**0.9**	4.7	3.4	2.3

Clearly, a sustained recovery of world oil prices is critical to Vermilion. The following cash flow sensitivity to changes in oil prices demonstrates the Company's ability to expand its capital budget significantly and to grow as prices recover in 1999.

Cash Flow Sensitivities

	$000s	$/share
Price		
Crude Oil (US$1.00/bbl)	5,400	$ 0.11
Natural Gas (Cdn$0.10/mcf)	800	$ 0.02
Production		
Crude Oil (100 bbls/d)	765	$ 0.02
Natural Gas (1.0 mmcf/d)	1,300	$ 0.03
Currency and Interest Rate		
Interest Rate (100 bpts)	1,050	$ 0.02
Exchange Rate (± Cdn$0.01)		
Cdn$/US$	350	$ 0.01
Cdn$/FF	280	$ 0.01

REVENUE

Due to the significant production increases, total oil and gas revenue climbed to $55.7 million in 1998 from the $53.7 million recorded a year ago. The average price for crude oil and NGLs of $14.22 per bbl in 1998 contrasts sharply with the $22.04 per bbl received in 1997 and reflects the impact of depressed world crude prices. In addition, the Company's average crude oil price in France was discounted $1.50 from Brent pricing due to timing of shipments in 1998. Vermilion's average natural gas price of $2.29 per mcf for 1998 was down from the $2.41 per mcf received in 1997. A decline in natural gas pricing in France was only partially offset by an increase in the average natural gas price in Canada from $1.99 per mcf to $2.23 per mcf. Vermilion's natural gas marketing strategies have ensured a continued strong average price for 1999 that is estimated to be in excess of $2.25 per mcf.

ROYALTIES

Total royalties (net of ARTC) increased to $10.5 million in 1998 compared with $8.6 million in 1997. Crude oil and NGLs royalties in Canada were 18 percent of revenue in 1998, relatively unchanged from 19 percent in the prior year. In France, the ratio increased to 22 percent in 1998 compared to 16 percent of revenue in 1997. The royalty structure in France is comprised of a federal royalty of five percent of revenue, with the remainder being a municipal production tax which represents a flat rate royalty of approximately $2.40 per bbl. The higher royalty in 1998 was the result of the flat rate royalty applied to revenue during a weak commodity cycle. In France, Vermilion is working with the industry group that is currently in discussions with various government bodies to restructure the production tax component of the royalty. The objective is to reduce the rates on incremental production from old fields and price-sensitize the formula to allow for reduced rates during low commodity price cycles. The Company anticipates royalty rates in France will improve in future years, dropping to levels below 1997 rates. This will be achieved through production growth, improved commodity prices and potentially a reduction in the legislated rates.

Natural gas royalties were 13 percent of revenue or $0.29 per mcf in 1998, down from 14 percent of revenue or $0.34 per mcf in the prior year. In 1998, with the additional revenue from successful drilling activity, Vermilion claimed the maximum ARTC of $1.3 million, accounting for the overall royalty rate reduction in Canada. In the future, the Company's adjusted Crown royalty rate will be closer to 18 percent of revenue.

Operating Statistics

Netbacks	Oil and NGLs	Gas	1998 Total	1997 Total	1996 Total
Canada					
Prices	$ 16.11	$ 2.23	$ 19.22	$ 20.52	$ 19.43
Royalties (net of ARTC)	(2.86)	(0.29)	(2.87)	(3.83)	(2.94)
Lifting Costs	(4.53)	(0.42)	(4.39)	(4.29)	(3.16)
Operating Netback	$ 8.72	$ 1.52	$ 11.96	$ 12.40	$ 13.33
France					
Prices	$ 13.69	$ 2.95	$ 14.10	$ 23.03	–
Royalties (net of ARTC)	(3.07)	(0.33)	(3.08)	(3.48)	–
Lifting Costs	(5.60)	(2.58)	(6.13)	(6.42)	–
Operating Netback	$ 5.02	$ 0.04	$ 4.89	$ 13.13	–
Combined					
Prices	$ 14.22	$ 2.29	$ 15.91	$ 22.38	$ 19.43
Royalties (net of ARTC)	(3.03)	(0.29)	(3.00)	(3.57)	(2.94)
Lifting Costs	(5.37)	(0.61)	(5.51)	(5.87)	(3.16)
Operating Netback	$ 5.82	$ 1.39	$ 7.40	$ 12.94	$ 13.33

INTEREST

Higher interest expense in 1998 was the result of higher debt levels associated with the Company's growth. Vermilion has maintained an average cost of debt of eight percent, of which 6.1 percent represents the interest costs of borrowing and 1.9 percent relates to amortization of arrangement fees incurred to expand the bank facility in 1998 and other costs of administering the facility and property acquisitions.

The Company will manage its cost of debt in 1999 by reducing its letter of credit/guarantee exposure in the first quarter of 1999. In addition, Vermilion entered into foreign currency interest swap arrangements on $13.7 million of face value of the credit facility which lock in rates between 5.3 percent and 5.7 percent. Management continues to review the potential of using further swaps to lock in interest costs for up to 25 percent of the total loan facility utilized.

Debt and Interest Expense

000s	1998	1997	1996
Debt at Year end	$ 93,903	$ 17,549	$ 13,684
Total Credit Facility	$ 115,000	$ 60,000	$ 30,000
Interest Expense	$ 2,661	$ 615	$ 463
Average Cost of Debt (%)	8.0	7.4	6.6

GENERAL AND ADMINISTRATIVE EXPENSES

The Company's gross general and administrative (G&A) expenses for 1998 of $6.9 million were more than one and a half times those of a year ago. Increased staff levels were directly associated with the extensive capital program in 1998. Vermilion has entered the development and exploratory phases of its corporate strategy for both Chip Lake and its French properties. As a result, the Company has strengthened its exploration team in an effort to identify new opportunities through Vermilion's vastly expanded undeveloped land base, while continuing its development and exploitation program. Another area of focus in 1998 was the corporate development activities supporting the $67.0 million acquisition program. Increased production levels and overhead recoveries in 1998 allowed Vermilion to reduce G&A expenses on a volumetric basis to $1.28 per boe from $1.36 per boe in 1997.

General and Administrative Expenses

000s	1998	1997	1996
Gross G&A	$ 6,882	$ 4,092	$ 898
Recoveries	(1,756)	(257)	(101)
	5,126	3,806	797
Capitalized G&A	(663)	(555)	(52)
Net G&A	$ 4,463	$ 3,280	$ 745
$/boe	$ 1.28	$ 1.36	$ 1.55

Cash Flow Per Boe

Years Ended December 31	1998	1997	1996
Oil and Gas Revenue	$ 15.91	$ 22.38	$ 19.43
Royalties (net of ARTC)	(3.00)	(3.57)	(2.94)
Production Expenses	(5.51)	(5.87)	(3.16)
Operations Netback	$ 7.40	$ 12.94	$ 13.33
General and Administrative Expense	(1.28)	(1.36)	(1.55)
Interest Expense	(0.76)	(0.26)	(0.96)
Capital Taxes	(0.10)	(0.10)	(0.12)
Marketing, Foreign Exchange and Other	0.30	(0.22)	0.08
Cash Flow per boe	$ 5.56	$ 11.00	$ 10.78

DEPLETION AND DEPRECIATION

Vermilion's average depletion rate of $3.87 per boe continues to be within the Company's target rate of $5.00 per boe despite being higher than the 1997 rate of $3.06 per boe (gas calculated on a 10:1 ratio).

The Company provides for expected future costs associated with site restoration and abandonment of facilities and wells. This is included in the depletion and depreciation provision. At year-end 1998, the provision for site restoration costs was $21.2 million from $19.2 million in 1997.

Depletion and Depreciation Expense

Years ended December 31 000s	1998	1997
Depletion and Depreciation Expense	**$ 13,534**	$ 7,350
Depletion and Depreciation Expense per boe	**$ 3.87**	$ 3.06

INCOME TAXES

The Company paid cash taxes in 1998 of $182,000 including the Large Corporations Tax for the year. Vermilion's tax horizon in both Canada and France has been extended beyond a one-year horizon. The tax pool balances of $85.0 million in Canada and $90.7 million in France will shelter the Company's cash flow for 1999 and potentially 2000, unless a significant crude oil price recovery occurs.

Canadian Tax Pools

December 31, 1998	Rates	$000s
Canada		
Canadian Exploration Expense	100%	$ 5,500
Canadian Development Expense	30%	18,650
Canadian Oil and Gas Property Expense	10%	35,000
Undepreciated Capital Cost	25%	21,850
Share Issue Costs	1/5	4,000
Total Canada		$ 85,000
France		
Seismic	50%	$ 2,100
Intangible Costs	25%	$ 49,700
Production Tangible Costs	30%	$ 21,600
Other Tangible Costs and Building	10%	$ 2,500
Non-Capital Losses	100%	$ 14,800
Total France		$ 90,700

The Company's deferred tax provision in 1998 of $1.5 million, combined with the cash taxes, represents an effective corporate tax rate of 31.8 percent, compared to $7.7 million in 1997 with an effective rate of 39.4 percent. The statutory tax rates in Canada and France remain unchanged at 44.6 percent and 41.7 percent, respectively. The only structural change to the corporate tax environment in 1998 was the removal of the Large Corporations Tax levy of 12 percent in France through successful lobbying efforts by the petroleum industry group.

CAPITAL EXPENDITURES

Vermilion significantly expanded its capital program in 1998 to $149.7 million. In Canada, the Company spent $67.0 million on acquisitions, of which $34.9 million was allocated to the consolidation of lands and production at Chip Lake and a net $32.2 million was spent on the acquisition of a new project area at Utikuma.

The Company allocated $28.1 million to its development capital program in Canada, drilling 24 gross (19.7 net) wells with an average success rate of 89 percent. Within this program, the Company spent $8.6 million on facility acquisitions and upgrades and major compressor replacements and overhauls. These facility acquisitions and upgrades at Chip Lake allowed the Company to expand its unutilized gas facility capacity from 7.5 mmcf/d to 37.8 mmcf/d, while adding 5,000 barrels of oil processing capacity. At Utikuma, Vermilion acquired 13,000 boe/d of unutilized crude oil and water handling capacity, ensuring long-term growth potential for the area.

In France, the development capital program of $55.0 million resulted in the drilling of 11 gross (11 net) wells, eight of which were successful oil wells. In the Paris Basin, an area in the early stages of development, $9.9 million was spent to enhance facilities and pipeline capacity. The 1998 drilling program in France focused on delineating existing pools at Champotran, Vulaines and Malnoue, identifying a new pool at Mothes, drilling new horizons at Parentis and testing an exploration concept at Vexin. Production from the wells drilled in 1998 in France has not yet been optimized as stimulation work is needed in 1999. The 1998 drilling program helped identify a multitude of follow-up locations currently under evaluation for development as oil prices improve.

CAPITAL RESOURCES

Vermilion's approach to funding its capital program through the three-phased corporate strategy remains unchanged: leverage is used in the acquisition phase, while cash flow and equity are used to develop and exploit the acquired asset. This financing strategy ensures that a reliable cash flow platform exists prior to incurring exploration expenditures. In addition, the assets acquired provide an adequate borrowing base to support bank financing.

Vermilion funded its 1998 capital expenditure program of $149.8 million with $43.8 million of equity, $19.6 million of cash flow and $86.3 million of combined debt and working capital.

Equity financing of $40.0 million was completed in March 1998 through the issuance of 5.1 million common shares at $7.90 per share. The Company was then positioned to implement an extensive development program on its existing properties using the proceeds from the financing in combination with its cash flow. In December 1998, Vermilion completed a $4.9 million flow-through financing at $3.75 per share. The proceeds will be used for exploration expenditures to be incurred in 1999. Vermilion used its bank facility to support $86.3 million of capital expenditures, including strategic acquisitions in Canada totalling $67.0 million.

Historically, Vermilion has maintained a conservative debt profile targeting a debt to cash flow ratio under 2:1. The Company used leverage in 1998 as a weak commodity price environment presented Vermilion with the opportunity to acquire a new project area at Utikuma, Alberta. With the continued price erosion in the first quarter of 1999, cash flow has been reduced to a level where the first quarter debt to cash flow ratio is well above management's threshold. However, the strength and profitability of Vermilion's production base will bring the debt to cash flow ratio to within the Company's target range with a slight increase in world oil prices to the US$15.00 WTI level. Management is approaching 1999 with caution by maintaining capital expenditures within cash flow.

Capital Expenditures

000s	1998	1997	1996
Land and Seismic	$ **6,427**	$ 5,612	$ 1,126
Drilling and Completion	**46,716**	18,211	4,860
Production Equipment and Facilities	**21,683**	5,980	853
Workovers	**5,828**	10,097	–
Capitalized Exploration Administration	**663**	555	52
Drilling and Development Expenditures	**81,317**	40,455	6,891
Property Acquisitions/Dispositions	**34,923**	37,881	20,352
Corporate Acquisitions (Utikuma)	**32,174**	–	–
Other	**1,356**	298	185
	$ **149,770**	$ 78,634	$ 27,428

Funding of Capital Expenditures

000s	1998	1997	1996
Cash Flow	$ **19,621**	$ 26,407	$ 5,169
Debt and Working Capital	**86,325**	7,835	8,452
Equity	**43,824**	44,392	13,807
	$ **149,770**	$ 78,634	$ 27,428

RISK MANAGEMENT

Crude oil and natural gas exploration, production, acquisition and marketing operations involve a number of business risks. Such risks include fluctuations in commodity prices, exploration risk, product demand, transportation restrictions, exchange rate fluctuation, interest rates and governmental regulatory changes.

Vermilion hired an external consulting firm to assess the commodity and currency risks and assist with the development of a risk management strategy that has since been incorporated in the Company's planning and budgeting process. Maintenance of a strong financial position and a stable cash flow stream through the development of long-life reserves are key to mitigating all business risks.

COMMODITY RISK

The significant decline in world oil prices underscores the importance of effective hedging strategies. Vermilion's strategy balances an assessment of the Company's financial position against historical pricing and market research with the objective of protecting the capital program during weak commodity cycles. As Vermilion entered this downturn with a clean balance sheet and no restrictions to its capital program, there was no immediate need to hedge 1998 production. Over the year, crude oil traded well below the 10-year trading band, making it difficult to lock in prices, even at levels below long-term averages. A "knee-jerk" reaction to hedging at that time would have limited commodity upside. Recently, however, guarding against commodity downside has become crucial with increased debt levels. Increased access to natural gas markets in the U.S. has allowed producers to lock in prices well above historical levels. Vermilion has used a balanced portfolio approach and protected approximately 60 percent of its current natural gas production from market price fluctuation while ensuring extremely attractive operating netbacks. Management will continue to evaluate the marketplace, adopting appropriate hedging mechanisms when necessary to protect future capital programs.

CURRENCY RISK

The Company's exposure to currency risk lies primarily in the U.S. dollar denominated revenue stream for both Canada and France. Management is currently reviewing all U.S. dollar denominated debt instruments to balance this exposure. Such vehicles are being considered as the Canadian dollar has been trading at historical lows in comparison to its 10-year trading range. Vermilion's exposure to fluctuations in the French franc is limited primarily to reinvestment and repatriation of funds. Forward sale and swap contracts can be used to mitigate such risks. The remaining cash flow from our French operations is reinvested within France and creates a natural hedge to the working capital and cash flow stream once converted to French francs.

YEAR 2000

The Year 2000 (Y2K) concerns have been widely publicized, raising public awareness to extraordinary levels. Vermilion began Y2K planning in September 1997. An internal committee of financial and operational personnel was created and external consultants were engaged to provide technical expertise. The review process targets two key areas: oilfield production controls and facilities; and computer hardware and software.

During 1998, the consulting firm completed its review of all production operations and facilities in the Chip Lake, Paris Basin and Aquitaine Basin project areas, with the recently-acquired Utikuma area to be completed in the first quarter of 1999. The review consisted of the following activities:

- Preparation of a detailed inventory of all parts, devices, controls, meters, valves, etc.;
- Compliance gathering and risk assessment;
- Impact assessment; financial safety, environmental and corporate image; and,
- Recommendations for replacement of equipment.

Upon completion of the review, the estimated costs of upgrading equipment and facilities is $300,000. Vermilion's operations in France carry the same high standards as in Canada with the use of similar field equipment. No unusual costs are anticipated and all costs incurred will be expensed.

For computer hardware and software reviews, the Company's external consultants performed extensive testing using specialized software, in addition to testing hardware for time clock advancement. The majority of software and hardware used by Vermilion is current and has been developed with Y2K specifications in mind. Only minor hardware upgrades are necessary. Vermilion is now receiving Y2K responses from all industry partners, major suppliers, service companies and transportation/sales agents.

MANAGEMENT'S REPORT TO SHAREHOLDERS

The accompanying consolidated financial statements of Vermilion Resources Ltd. are the responsibility of management and have been approved by the Board of Directors. The financial statements have been prepared in accordance with accounting policies detailed in the notes to the financial statements and are in accordance with accounting principles generally accepted in Canada. Where necessary, management has made informed judgments and estimates of transactions which were not complete at the balance sheet date. Financial information throughout the Annual Report is consistent with the financial statements.

Management ensures the integrity of the financial statements by maintaining high quality systems of internal control. Procedures and policies are designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded, and that the financial records are reliable for preparation of the financial statements.

KPMG LLP, the Company's external auditors, have conducted an examination of the consolidated financial statements in accordance with generally accepted auditing standards in Canada and have provided an independent opinion.

The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board carries out this responsibility principally through the Audit Committee which is appointed by the Board and is comprised of a majority of Directors who are not employees of the Company. The Committee meets periodically with management and the external auditors to satisfy itself that each party is properly discharging its responsibilities and to review the consolidated financial statements, the Management's Discussion and Analysis and the external Auditors' Report before they are presented to the Board of Directors.

Jeffrey S. Boyce
President & Chief Executive Officer

Stephen E. Bjornson
Vice President, Finance & Corporate Secretary

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Vermilion Resources Ltd. as at December 31, 1998 and 1997 and the consolidated statements of earnings and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG LLP.

Chartered Accountants
Calgary, Canada
March 5, 1999

CONSOLIDATED BALANCE SHEETS

December 31 $000s	1998	1997
Assets		
Current assets:		
Cash	$ 1,370	$ 2,874
Accounts receivable	11,408	15,333
Crude oil inventory	2,810	3,168
Prepaid expenses and other	1,616	517
	17,204	21,892
Notes receivable	–	85
Deferred charges	591	–
Capital assets (note 3)	246,918	108,254
	$ 264,713	$ 130,231
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 32,549	$ 24,769
Production tax liability	1,050	–
Long-term debt (note 4)	93,903	17,549
Employee benefit liability (note 11)	730	730
Provision for future site restoration	2,988	1,580
Deferred income taxes (note 7)	9,736	7,881
	140,956	52,509
Shareholders' equity:		
Share capital (note 5)	107,187	64,590
Retained earnings	16,570	13,132
	123,757	77,722
Commitments and contingencies (note 10)		
	$ 264,713	$ 130,231

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Jeffrey S. Boyce
Director

Charles W. Berard
Director

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

Years ended December 31 **$000s, except per share amounts**	1998	1997
Revenue:		
Petroleum and natural gas revenue	**$ 55,660**	$ 53,693
Royalties (net)	**10,509**	8,557
	45,151	45,136
Gas marketing loss (note 6)	–	(532)
Other income	**1,062**	–
	46,213	44,604
Expenses:		
Production	**19,283**	14,088
Interest	**2,661**	615
General and administration	**4,463**	3,280
Foreign exchange	**1,000**	(29)
Depletion and depreciation	**13,534**	7,350
	40,941	25,304
Earnings before income taxes	**5,272**	19,300
Income taxes:		
Deferred (note 7)	**1,494**	7,699
Current	**182**	77
Capital	**158**	166
	1,834	7,942
Net earnings	**3,438**	11,358
Retained earnings, beginning of year	**13,132**	1,774
Retained earnings, end of year	**$ 16,570**	$ 13,132
Net earnings per Common Share:		
Basic	**$ 0.07**	$ 0.30
Fully diluted	**$ 0.07**	$ 0.29

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31 $000s, except per share amounts	1998	1997
Cash provided by (used in):		
Operations:		
Net earnings	$ 3,438	$ 11,358
Items not affecting cash:		
Depletion and depreciation	13,534	7,350
Foreign exchange loss (gain)	1,000	(29)
Amortized deferred financing charges	155	–
Deferred income taxes	1,494	7,699
Funds generated from operations	19,621	26,378
Changes in non-cash working capital	9,146	5,609
	28,767	31,987
Investments:		
Acquisition of capital assets, net	(34,804)	(46,039)
Drilling and development of petroleum and natural gas properties	(82,792)	(40,753)
Corporate acquisition (note 2)	(32,174)	–
Unrealized foreign exchange gain (loss)	(1,000)	29
Site restoration costs incurred	(69)	–
Pre-acquisition costs	–	8,158
	(150,839)	(78,605)
Financing:		
Decrease in pre-acquisition financing	–	(7,830)
Increase in long-term debt	76,354	11,975
Increase in other liabilities	–	730
Issue of Common Shares for cash, net of share issue costs	43,824	44,392
Production tax liability	1,050	–
Increase in deferred charges	(745)	–
Decrease in notes receivable	85	225
	120,568	49,492
Net change in cash	(1,504)	2,874
Cash, beginning of year	2,874	–
Cash, end of year	$ 1,370	$ 2,874
Funds from operations per share:		
Basic	$ 0.42	$ 0.70
Fully diluted	$ 0.41	$ 0.67

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 1998 and 1997

(Tabular amounts in thousands of dollars, except per share amounts)

1. SIGNIFICANT ACCOUNTING POLICIES:

(A) PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, all of which are wholly-owned.

(B) CAPITAL ASSETS:

The Company uses the full-cost method of accounting for petroleum and natural gas operations and, accordingly, capitalizes all exploration and development costs. These costs include land acquisition, geological and geophysical costs, drilling (including related overhead) on producing and non-producing properties and other carrying charges on unproven properties. Proceeds of disposition are applied against the cost pools with no gain or loss recognized except where the disposition results in a significant change in the rate of depletion and depreciation.

The cost of significant unevaluated properties are excluded from the depletion and depreciation base. The carrying value is limited to the recoverable amount as determined by estimating the present value of future net revenues from proven properties based on current prices and costs and the value of unproven properties at the lower of cost and net realizable value less estimated future site restoration costs, general and administrative expenses, financing costs and income taxes. Amortization of these costs is calculated on the unit-of-production method based on estimated proven reserves, before royalties, as determined by independent engineers. For purposes of depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content.

(C) FURNITURE AND EQUIPMENT:

Furniture and equipment are recorded at cost and are being amortized on a declining balance basis at rates of 20 percent to 50 percent per year.

(D) JOINT VENTURES:

Substantially all of the exploration, development and production activities of the Company are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(E) PROVISION FOR FUTURE SITE RESTORATION:

The Company estimates its future site restoration and abandonment costs for its oil and gas properties. The costs represent management's best estimate of the future restoration and abandonment costs based upon current legislation and industry practices. Total estimated costs are

being provided for on a unit-of-production basis. The annual provision included in amortization expense and actual site restoration costs are charged to the account as incurred.

(F) DEFERRED CHARGES:

Deferred charges relate to the costs associated with long-term debt acquired in the year as well as the deferred foreign exchange loss with respect to cross currency interest rate swap contracts. The deferred costs associated with long-term debt are amortized on a straight-line basis over the life of the debt obligation. Amortization expense of $155,000 was recognized in 1998 with respect to these deferred costs. The deferred foreign exchange loss at December 31, 1998 was $286,000.

(G) DERIVATIVE FINANCIAL INSTRUMENTS:

The Company is party to certain derivative financial instruments, principally cross currency interest rate swap contracts which are used to manage the exposure to interest rate cash flow risk. These instruments are not recognized in the consolidated financial statements on inception. Payments and receipts under interest rate swap contracts are recognized as adjustments to interest expense on long-term debt. The Company has hedged foreign currency denominated debt, with respect to the cross currency swap, by future revenue streams. The amount included in the determination of net earnings of future periods is the foreign currency amount translated at the exchange rate in effect when the revenue stream was identified as a hedge. The difference arising due to cash received being translated at the current rate is deferred and offset against the deferred amount relating to the foreign currency denominated debt. Any costs relating to the hedge are recognized in earnings over the period for which the hedge is in effect.

In addition, the Company uses financial instruments from time to time to hedge its exposure to fluctuations in oil and natural gas prices, foreign exchange rates and interest rates. Gains or losses from these activities are reported as adjustments to the related revenue or expense accounts when the gain or loss is realized.

(H) MEASUREMENT UNCERTAINTY:

The amounts recorded for depletion and depreciation of property, plant and equipment and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements from changes in such estimates in future periods could be significant.

(I) EARNINGS PER SHARE:

Earnings per share and funds from operations per share are calculated using the weighted average number of shares outstanding during the year. Fully diluted earnings per share, where applicable, reflect the exercise of options and issuance of Common Shares for warrants as if issued at the later of the date of grant or the beginning of the year.

(J) FLOW-THROUGH SHARES:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Capital assets and share capital are reduced by the estimated cost of the renounced tax deduction when the expenditures are incurred.

(K) FOREIGN CURRENCY TRANSLATION:

Foreign currency balances of foreign subsidiaries, which are considered to be integrated, are translated on the following basis:

- Monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet dates.
- Non-monetary assets, liabilities and related depreciation and depletion expense are translated at historical rates.
- Sales, other revenues, royalties and all other expenses are translated at the average rate of exchange during the month in which they are recognized.

Any resulting foreign exchange gains and losses are included in earnings.

(L) DEFERRED INCOME TAXES:

The Company follows the deferral method of tax allocation accounting under which the provision for corporate income taxes is based on earnings reported in the accounts and takes into account the tax effect of timing differences between financial statement income and taxable income.

2. BUSINESS ACQUISITION:

On November 4, 1998 the Company signed a letter agreement to purchase all the outstanding shares of 764031 Alberta Ltd., a private Canadian oil and gas company for total consideration of $32,174,000. The arrangement closed on December 1, 1998 at which time 764031 Alberta Ltd. became a wholly owned subsidiary of the Company. The combination of 764031 Alberta Ltd. was accounted for as an acquisition using the purchase method of accounting as follows:

Allocation of Purchase Price:

Capital assets	$ 38,293
Current assets	263
Current liabilities	(2,080)
Deferred income taxes	(1,331)
Note payable	(2,910)
Site restoration	(61)
	$ 32,174

3. CAPITAL ASSETS:

	Cost	Accumulated depletion and depreciation	Net book value
1998			
Petroleum and natural gas properties and equipment	$ 266,348	$ 20,087	$ 246,261
Furniture and equipment	972	315	657
	$ 267,320	$ 20,402	$ 246,918
1997			
Petroleum and natural gas properties and equipment	$ 115,959	$ 8,123	$ 107,836
Furniture and equipment	577	159	418
	$ 116,536	$ 8,282	$ 108,254

As at December 31, 1998, costs of $15,200,000 (December 31, 1997 - $15,000,000) for unproven properties have been excluded from the depletion calculation. During the year, the Company capitalized $662,965 (December 31, 1997 - $555,360) of overhead costs related to exploration and development activities.

Included in capital assets are $37,633,837 (December 31, 1997 - $3,384,000) of petroleum and natural gas properties with no income tax basis.

The provision for future site restoration costs is recorded in the statement of earnings as a component of depletion and depreciation and on the balance sheet as a long-term liability. At December 31, 1998, the estimated future site restoration costs to be accrued over the life of the remaining proven reserves are $21,158,405 (December 31, 1997 - $19,172,200).

4. LONG-TERM DEBT:

At December 31, 1998, the Company had a $100,000,000 revolving Credit Facility as well as a $15,000,000 Supplemental Facility. The Credit Facility has a four year term attached to a one year extendible revolving period. The Credit Facility bears interest at the bank's prime rate per annum when borrowings are less than 75 percent of the borrowing base and, thereafter, at prime rate plus 0.25 percent per annum. The Supplemental Facility is repayable on the earlier of June 1, 1999 or a refinancing of the Credit Facility and bears an interest at 0.5 percent over the bank's prime rate per annum.

The Company has pledged as collateral a $160,000,000 first priority floating demand debenture over all the assets of the Company and an undertaking to provide additional security upon request.

To reduce the interest rate cash flow risk on the Credit Facility, the Company entered into cross currency interest rate swap contracts whereby the Company received FRF 25,000,000 and FRF 30,000,000 in exchange for $6,000,000 and $7,382,071 respectively. The Company is entitled to receive interest at floating rates on the Canadian dollar principal amounts and is required to pay interest at fixed rates of 4.30 percent

and 4.67 percent (before stamping fees) respectively on the French franc principal amounts. The net interest receivable or payable under the contracts is settled quarterly with the counterparty, which is a United States bank. Pursuant to the contracts, the Company is required to exchange the FRF 25,000,000 and FRF 30,000,000 for Canadian dollars in 2000 and 2001 respectively.

5. SHARE CAPITAL:

(A) AUTHORIZED:

Unlimited number of Common Shares

Unlimited number of Preferred Shares

(B) COMMON SHARES ISSUED:

	Number of Shares	Amount
Balance, December 31, 1996	29,909,864	$ 19,482
Issued for cash through Special Warrants	10,000,000	45,000
Warrants exercised for cash	656,570	675
Stock options exercised for cash	1,503,250	751
Flow through share offering	84,654	555
Share issue costs, net of deferred tax of $1,155,179	–	(1,434)
Tax effect on flow-through shares issued	–	(439)
Balance, December 31, 1997	42,154,338	64,590
Common shares issued for cash	5,063,291	40,000
Stock options exercised for cash	673,250	1,146
Flow-through share offering	1,312,838	4,923
Share issue costs, net of deferred tax of $969,398	–	(1,219)
Normal course issuer bid shares acquired	(15,200)	(56)
Tax effect on flow-through shares issued	–	(2,197)
Balance, December 31, 1998	**49,188,517**	**$ 107,187**

On March 26, 1998, the Company closed an equity financing to issue 5,063,291 Common Shares at $7.90 per share for net proceeds of $38,780,152 after deducting $1,219,848 of share issue costs net of the associated deferred tax benefit of $969,398.

(C) FLOW-THROUGH SHARES:

Pursuant to flow-through share agreements dated December 23, 1998, the Company had renounced resource expenditures of $4,923,142 prior to February 28, 1999. The Company is committed to incur the qualifying expenditures prior to December 31, 1999.

(D) STOCK OPTIONS:

The Company has a stock option plan under which the Board of Directors may grant stock options to directors, officers and employees for the purchase of Common Shares. At December 31, 1998, the Company has outstanding a total of 4,656,643 (December 31, 1997– 3,425,983) options under the

Stock Option Plan. The options are exercisable at prices from $0.70 to $6.55 and expire at various dates between 2001 and 2003.

(E) NORMAL COURSE ISSUER BID:

Effective October 9, 1998, the Company commenced a normal course issuer bid process to purchase the Company's common shares. The bid was approved to purchase up to 5 percent of the issued and outstanding common shares, or 2,391,944 common shares and will terminate on October 8, 1999.

6. GAS MARKETING:

	1998	1997
Gas marketing sales	$ –	$ 33,821
Gas marketing purchases	–	(34,275)
Net marketing margin	–	(454)
Direct costs	–	(78)
Gas marketing	$ –	$ (532)

On November 1, 1997, the Company ceased its third party natural gas marketing activities.

7. DEFERRED INCOME TAXES:

The provision for income taxes differs from the result which would be obtained had the combined statutory income tax rates for the respective Canadian and foreign jurisdictions been applied to net income. The actual income tax expense differs from the amount that would have been expected if the reported earnings had been subject only to the statutory Canadian income tax rate of 44.6 percent.

	1998	1997
Earnings before income taxes	$ 5,272	$ 19,300
Corporate tax rate	44.6%	44.6%
Expected tax expense	2,351	8,608
Increase (decrease) in taxes resulting from:		
Non-deductible crown payments	1,774	892
Resource allowance	(1,566)	(776)
Alberta Royalty Tax Credit	(618)	(282)
Non-deductible depletion	148	92
Other	111	45
Foreign exchange	–	201
Foreign tax rate differentials	(524)	(1,004)
Provision for income taxes	$ 1,676	$ 7,776

At December 31, 1998, the Company has approximately $85,000,000 (December 31, 1997 - $35,300,000) of tax pools for Canadian income tax purposes.

8. RELATED PARTY TRANSACTIONS:

As at December 31, 1998 the Company has $nil (December 31, 1997 - $85,000) of notes receivable reflecting non-interest bearing loans due from certain officers and management of the Company for the purchase of Common Shares.

9. FINANCIAL INSTRUMENTS:

(A) RISK MANAGEMENT ACTIVITIES:

The nature of the Company's operations result in exposure to fluctuations in commodity prices, exchange rates and interest rates. The Company monitors and, when appropriate, utilizes derivative financial instruments to manage its exposure to these risks. The Company is exposed to credit-related losses in the event of non-performance by counterparties to the financial instruments. The Company deals with only major financial institutions and does not anticipate non-performance by the counterparties. At December 31, 1998, the Company has entered into cross currency interest rate swaps as described in note 4 to reduce its exposure to fluctuations in interest expense.

The Company is exposed to foreign currency fluctuations on its cash flow. At December 31, 1998, the Company has entered into cross currency interest rate swaps as described in note 4 which mature in 2000 and 2001 to exchange FRF 25,000,000 and FRF 30,000,000 for Canadian dollars respectively.

(B) FAIR VALUES:

The carrying values of cash, accounts receivable, short-term investments and accounts payable and accrued liabilities approximate their fair values. Long-term debt with variable interest rates are assumed to be at fair value and are not revalued.

The cross currency interest rate swaps had fair values of $8,502,780 and $6,969,430 at December 31, 1998. At March 5, 1999 the fair values were $7,637,630 and $6,245,298.

10. COMMITMENTS AND CONTINGENCIES:

At December 31, 1998, the Company had a letter of credit outstanding for 49,600,000 French francs (approximately Cdn$13,600,000) in favour of the vendor of the properties acquired in France, which secures certain indemnities given to the vendor. The letter of credit will be reduced to 19,900,000 French francs (approximately Cdn$5,500,000) upon the formal transfer of titles of the French assets which is anticipated to occur in early 1999. The letter of credit expires July 1999 and has a 10 percent drawdown upon annual renewal.

11. EMPLOYEE BENEFITS LIABILITY:

The employee benefits liability represents amounts estimated to be owed to certain employees in France who were transferred to Vermilion's operations in 1997. The amounts owing relate to a supplemental retirement benefits plan for which the Company has no obligation to continue the plan beyond May 9, 1999. If the plan

is discontinued, the Company has the options to pay out the benefits immediately to employees, or carryforward the benefits into a new plan, or carryforward the benefits until retirement without a new plan.

12. SEGMENTED INFORMATION:

The Company has operations in Canada and France. The Company's entire operating activities are related to exploration, development and production of petroleum and natural gas.

	1998	1997
Petroleum and natural gas revenues:		
Canada	$ 23,806	$ 12,709
France	31,854	40,984
	$ 55,660	$ 53,693
Net earnings:		
Canada	$ 8,246	$ 3,157
France	(4,808)	8,201
	$ 3,438	$ 11,358
Funds generated from operations:		
Canada	$ 15,678	$ 6,624
France	3,943	19,754
	$ 19,621	$ 26,378
Capital expenditures:		
Canada	$ 94,726	$ 11,051
France	55,044	67,583
	$ 149,770	$ 78,634
Identifiable assets:		
Canada	$ 142,903	$ 48,147
France	121,810	82,084
	$ 264,713	$ 130,231

13. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect the Company's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

FIVE YEAR SUMMARY

Fiscal Year Ending December 31 $000s except per share amounts	1998	1997	1996	1995	1994
FINANCIAL					
Petroleum and Natural Gas Revenues	$ 55,660	$ 53,693	$ 9,323	$ 2,077	$ 385
Cash Flow from Operations	19,621	26,378	5,169	1,085	145
Per Share	0.42	0.70	0.24	0.08	0.02
Net Earnings	3,438	11,358	1,866	243	27
Per Share	0.07	0.30	0.09	0.02	–
Capital Expenditures	149,770	78,634	27,428	9,022	2,237
Total Assets	264,713	130,231	44,246	19,609	2,265
Total Long-Term Debt	93,903	17,549	13,404	4,269	600
Shareholders' Equity	$ 123,757	$ 77,722	$ 21,256	$ 5,366	$ 1,517
Common Shares Outstanding					
End of Period	49,188,517	42,154,338	29,909,864	16,367,071	9,350,000
Weighted Average	46,705,676	37,773,872	21,403,004	14,473,854	6,303,563
Fully Diluted, End of Period	53,845,160	45,580,231	32,982,935	19,116,482	11,000,000
Share Trading					
High	$ 9.25	$ 9.75	$ 4.50	$ 0.85	$ 0.85
Low	2.50	3.85	0.70	0.45	0.19
Close	$ 2.85	$ 8.25	$ 4.50	$ 0.75	$ 0.51
OPERATIONS					
Production					
Crude Oil (bbls/d)	6,877	4,825	229	77	33
NGLs (bbls/d)	838	651	318	98	2
Natural Gas (mcf/d)	18,676	10,973	7,600	1,835	170
Total (boe/d)	9,583	6,573	1,307	359	52
Average Selling Price					
Crude Oil ($/bbl)	$ 14.34	$ 22.33	$ 26.93	$ 19.49	$ 20.18
NGLs ($/bbl)	13.18	19.93	21.50	15.78	15.06
Natural Gas ($/mcf)	2.29	2.41	1.63	1.43	2.11
Operations Netback (per boe)	7.40	12.94	13.33	10.29	13.13
Cash Flow Netback (per boe)	$ 5.56	$ 11.00	$ 10.78	$ 8.28	$ 7.66
Established Reserves					
Crude Oil (mbbls)	51,486	34,876	1,330	673	295
NGLs (mbbls)	7,844	5,451	2,758	1,376	10
Natural Gas (mmcf)	139,950	104,486	60,004	15,053	1,682
Total (Mboe)	73,325	50,776	10,088	3,554	473
Undeveloped Land Holdings (net acres)	884,092	256,053	45,450	18,881	1,312
Finding Costs (per proven boe)	$ 6.28	$ 2.34	$ 3.16	$ 3.64	$ 3.95
Net Asset Value per Share	$ 6.27	$ 6.67	$ 2.00	$ 0.89	$ 0.24
Recycle Ratio	0.9	4.7	3.4	2.3	1.9

CANADIAN STAFF

Sandy Abdallah	Production Accountant
Charles Anderson	Operator - Level 1
Ron Andriuk	Senior Geologist
Annie Arguile	Executive Secretary
Chris Baker	Vice President, Exploration
Tom Banks	Manager, Engineering (Chip Lake)
Steve Bjornson	Vice President, Finance & Corporate Secretary
Leslie Bodell	Senior A/P Accountant
Kendall Bohning	Maintenance Operator - Level 1
Colleen Boos	Human Resources Administrator
Jeff Boyce	President & Chief Executive Officer
Laurie Bradford	Land Secretary
Rob Brown	Geologist
Cindy Buote	Receptionist
Ray Carbert	Operator - Level 1
Steve Charbonneau	Senior Geologist
Maria Comrie	Senior Geologist
Lorenzo Donadeo	Executive Vice President
Vince Farkas	Manager, Engineering (Utikuma)
Mike Foster	Operator - Level 3
Claudio Ghersinich	Executive Vice President
Eric Gladue	Operator - Level 2
Dave Griffith	Senior Geophysicist
Brian Halldorson	Maintenance Operator - Level 3
Deb Hardtman	Accounting Administrator
Bob Hehn	Operator - Level 1
Jesse Jabs	Operator - Level 4
Brady Jensen	Operator - Level 3
Eric Key	Production Superintendent
Darren Kisser	Senior Operations Engineer
Adele Langer	Geological Technician
Janice Larson	Geological Technician
Rob Macaulay	Senior Petroleum Engineer
Monty MacEwen	Lead Operator/Coordinator
Debbie Mah	Executive Assistant
Paula Massitti	Joint Venture Accountant
Wendy Matchett	Senior Production Accountant
Susan McNutt	Senior Land Analyst
Kevin Radomske	Area Foreman (Chip Lake)
John Ramescu	Vice President, Land & Business Development
Elaine Reykdal	Surface Land Analyst
Tom Robertson	Exploration Manager
Nathalie Ruault	Secretary International
Rob Sadownyk	Senior Geologist
Judith Sloane	Gas Marketing Representative
Jack Smith	Controller
Paul Smith	Senior Landman
Heather Strang	Manager, Corporate Communications
Steve Stretch	Senior Geophysicist
Ian Walker	Senior Geologist
Lloyd Waters	Operator - Level 2
Blaine Wilson	Operator - Level 1

LISTE DU PERSONNEL EN FRANCE

Jean-Philippe Azpiazu	Opérateur dépôt /champs	Christophe Jourde	Opérateur instrumentiste
Béatrice Bach	Chef du personnel	Bernard Krakowiak	Chef opérateur
Brigitte Barland	Secrétaire opérations	Patrick Kwasniewski	Conducteur travaux/mécanique
Jean-Louis Bernede	Opérateur dépôt /champs	Donald Lajoie	Chef ingénieur production surface/fond
Noëlle Beylac	Comptable opérationnelle	Josette Larroze	Contrôle coûts/énergie
Alexandre Bichot	Opérateur instrumentiste	Didier Lechartier	Directeur études et projets
Michel Braga	Opérateur dépôt /champs	Christian Lopez	Opérateur dépôt/champs
Patrick Caillot	Directeur du développement et des relations publiques	Dominique Marin	Opérateur dépôt /champs
David Cannon	Directeur général	Kévin Orlandi	Apprenti
Yves Casier	Chef de champs	Michèle Pochart	Comptable
Patrick Catala	Coordonnateur logistique	Claude Poujardieu	Opérateur dépôt /champs
André Dadar	Employé administratif	Denis Quessard	Chef de groupe travaux/maintenance
Hervé Degoul	Chef de groupe maintenance	Michel Rembert	Conducteur des travaux électricité
Thierry Doumic	Responsable administratif district	Martin Robert	Directeur production
André Enenkel	Technicien corrosion/achats	André Sanchez	Chef comptable
Claude Engard	Technicien métrologie	Didier Sentucq	Mécanicien fond
Jacques Francois	Opérateur dépôt /champs	Michel Skoberne	Intendant pulling
Valérie Gaillard	Assistante technique	Thomas Valero	Conducteur de travaux GC/tuyauterie
Denis Gratton	Directeur de gestion	Jean-Pierre Verdier	Directeur administratif et financier
Gérard Herran	Coordonnateur exploitation	Ghislaine Vollaud	Comptable fournisseurs

DIRECTORS

Jeffrey S. Boyce (1)
Calgary, Alberta

Charles W. Berard (1) (2) (3)
Partner, MacLeod Dixon
Calgary, Alberta

Lorenzo Donadeo (3)
Calgary, Alberta

Claudio Ghersinich (2)
Calgary, Alberta

Joseph Killi (1) (2) (3)
President
Rosebridge Capital Corp.
Calgary, Alberta

(1) Audit Committee
(2) Compensation Committee
(3) Environment and Safety Committee

OFFICERS AND KEY PERSONNEL

CANADA

Jeffrey S. Boyce
President & Chief Executive Officer

Lorenzo Donadeo, P. Eng.
Executive Vice President

Claudio Ghersinich, P. Eng.
Executive Vice President

Chris Baker, B. Sc.
Vice President, Exploration

Stephen E. Bjornson, C.A.
Vice President Finance
& Corporate Secretary

John Ramescu, B. Comm.
Vice President, Land
& Business Development

FRANCE

David Cannon, P. Eng.
Directeur Général, Vermilion REP S.A.

AUDITORS

KPMG LLP
Calgary, Alberta

BANKERS

Chase Manhattan Bank of Canada
Toronto, Ontario

Crédit Commercial de France
Bordeaux, France

Crédit Lyonnais
Calgary, Alberta

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Toronto, Ontario

The National Bank of Canada
Calgary, Alberta

EVALUATION ENGINEERS

Adams Pearson Associates Inc.
Calgary, Alberta

Chapman Petroleum Engineering Ltd.
Calgary, Alberta

LEGAL COUNSEL

Howard Mackie
Calgary, Alberta

MacLeod Dixon
Calgary, Alberta

TRANSFER AGENT

Montreal Trust

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Symbol: "VRM"
TSE 300 Index

ABBREVIATIONS

bbls	barrels
bbls/d	barrels per day
bopd	barrels of oil per day
mbbls	thousand barrels
mcf	thousand cubic feet
mcf/d	thousand cubic feet per day
mmbbls	million barrels
mmcf	million cubic feet
mmcf/d	million cubic feet per day
boe	barrel of oil equivalent
boe/d	barrel of oil equivalent per day
mboe	thousand barrels of oil equivalent
mmboe	million barrels of oil equivalent
ARTC	Alberta Royalty Tax Credit
Conversion	10 mcf: 1 boe
Established Reserves	proven reserves plus 50% probable reserves

ANNUAL GENERAL MEETING

Vermilion's annual meeting will be held Thursday, June 24, 1999 at 3:00 p.m. in the McMurray Room at the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta. All shareholders are invited to attend, but those unable to do so are requested to sign and return the form of proxy mailed with this report to ensure representation at the meeting.

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